

Message Text

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TAGS:EFIN,ECON, OECD

SUBJ: U.S. SUBMISSION TO EPC/TWP

REF.: OECD 9522

FOLLOWING IS THE TEXT OF A SUBMISSION BY THE U.S. REPRESENTATIVE TO THE TEMPORARY WORKING PARTY OF THE ECONOMIC POLICY COMMITTEE ON PROBLEMS RELATED TO INVESTMENT OF FINANCIAL SURPLUSES BY OIL PRODUCERS

BEGIN TEXT

INTRODUCTION (UNDERScore)

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1. THIS NOTE IS SUBMITTED BY THE U.S. REPRESENTATIVE PURSUANT TO HIS OFFER AT THE FIRST MEETING OF THE TEMPORARY WORKING PARTY ON APRIL 10.

2. IT WILL BE RECALLED THAT AT THAT MEETING, THE U.S. REPRESENTATIVE SUGGESTED THAT THE GROUP SHOULD BEGIN ITS WORK BY SEEKING TO ANALYZE THE NATURE OF THE PROBLEMS FOR THE WORLD ECONOMY AND THE CONSUMING COUNTRIES WHICH ARISE FROM THE INVESTMENT OF THE FINANCIAL SURPLUS BEING ACCUMULATED BY OIL EXPORTING COUNTRIES. (THIS EXAMINATION WOULD NOT EXTEND TO QUESTIONS OF TREATMENT OF SUCH INVESTMENT BY CONSUMING COUNTRIES WHICH ARE BEING HANDLED IN THE INVESTMENT COMMITTEE.) SPECIFICALLY, THE U.S. REPRESENTATIVE LIMITED OFFICIAL USE

SUGGESTED THAT QUESTIONS TO BE LOOKED AT MIGHT INCLUDE THE PROBLEMS RESULTING FROM:

- THE MAGNITUDE OF THE ASSETS BEING ACCUMULATED
- THE DISTRIBUTION OF THESE ASSETS AMONG OPEC COUNTRIES
- THE INVESTMENT POLICIES OF THE PRODUCING COUNTRIES AS REGARDS GEOGRAPHIC AND CURRENCY DISTRIBUTION, TYPE OF ASSET, AND VOLATILITY AND MATURITY OF THE INSTRUMENT.

IN ADDITION IT WAS PROPOSED THAT THE GROUP EXAMINE THE ADVANTAGES AND DISADVANTAGES OF ADOPTING POLICIES DESIGNED TO INFLUENCE THE RATE AT WHICH REAL RESOURCES ARE TRANSFERRED TO OPEC NATIONS.

3. EACH OF THESE SUBJECTS IS TREATED IN THE FOLLOWING PARAGRAPHS.

THE MAGNITUDE OF OPEC ACCUMULATIONS (UNDERScore)

4. THERE HAS BEEN A GROWING CONSENSUS THAT THE FINANCIAL ACCUMULATIONS OF THE OIL PRODUCERS WILL NOT REACH THE VERY HIGH LEVELS PREDICTED BY SOME LAST YEAR. AMONG THE MOST PUBLICIZED OF LAST YEAR'S MORE PESSIMISTIC ESTIMATES WERE THOSE MADE BY THE WORLD BANK IN JULY, WHICH PROJECTED TOTAL OPEC FINANCIAL ACCUMULATIONS OF SOME \$650 LIMITED OFFICIAL USE LIMITED OFFICIAL USE

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BILLION BY 1980 AND OVER \$1200 BILLION BY 1985. (1) FOOTNOTE (1) READS: MORE RECENTLY, THE WORLD BANK HAS REVISED ITS PROJECTIONS DOWNWARD SUBSTANTIALLY TO \$250 BILLION IN CONSTANT DOLLARS. END FOOTNOTE. ESTIMATES SUCH AS THESE WERE DISQUIETING NOT ONLY BECAUSE THE PROJECTED ACCUMULATIONS WERE SO LARGE BUT ALSO BECAUSE THEY WERE EXPECTED TO CONTINUE AT A HIGH RATE WELL INTO OR THROUGH THE 1980'S.

5. PART OF THE REASON FOR THE LARGE SIZE OF THESE WORLD BANK ESTIMATES IS THAT THEY WERE EXPRESSED IN CURRENT RATHER THAN CONSTANT DOLLARS. (2) FOOTNOTE (2) READS:

FOR PROJECTIONS OF THIS NATURE, MOST FORECASTERS OTHER THAN THE IBRD HAVE EMPHASIZED CONSTANT DOLLARS AS THE UNIT OF MEASUREMENT. CONSTANT DOLLARS ARE USEFUL BECAUSE THEY YIELD AN APPROXIMATION OF THE CLAIMS ON REAL RESOURCES WHICH THE OPEC COUNTRIES ARE OBTAINING. THEY ALSO PRESENT THE CUMULATIVE FINANCIAL CLAIMS IN TERMS OF THE MAGNITUDE IN DOLLARS AS THEY ARE USUALLY COMPREHENDED, I.E., DOLLARS OF TODAY'S VALUE. ESTIMATES IN NOMINAL TERMS MAY BE HELPFUL IN THINKING ABOUT SOME PROBLEMS, FOR EXAMPLE BALANCE OF PAYMENTS FINANCING NEEDS.

IN LOOKING AT THESE FIGURES IN NOMINAL TERMS, HOWEVER, IT MUST BE KEPT IN MIND THAT OTHER FINANCIAL MAGNITUDES WILL ALSO TEND TO INCREASE WITH INFLATION. END FOOTNOTE. A DEFLATION OF THE IBRD ESTIMATES TO 1974 DOLLARS REDUCES THE \$650 BILLION FIGURE FOR 1980 TO APPROXIMATELY \$400 BILLION. THESE INITIAL WORLD BANK ESTIMATES WERE, IN ADDITION, BASED ON PESSIMISTIC ASSUMPTIONS CONCERNING THE RESPONSIVENESS OF OIL IMPORT DEMAND TO INCREASED PRICES, AS WELL AS THE MAINTENANCE OF THE CURRENT LEVEL OF REAL PRICES.

6. OTHER RECENT PROJECTIONS, INCLUDING THOSE OF THE OECD SECRETARIAT, WHICH ALSO ASSUME THE CURRENT REAL PRICE OF OIL IS MAINTAINED, PLACE THE LIKELY TOTAL OPEC ACCUMULATIONS BY 1980 IN THE RANGE OF \$105 TO \$250 BILLION IN 1974 DOLLARS. ACCUMULATIONS WOULD BE UNLIKELY TO PROVE SUBSTANTIALLY HIGHER IN 1985 THAN IN 1980, AND SOME PROJECTIONS EXPECT THE PEAK IN ACCUMULATIONS TO OCCUR BEFORE 1980. THE PROJECTION OF THE MORGAN GUARANTY
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TRUST COMPANY CALLS FOR A PEAK OF \$170 BILLION IN 1978 AND A DECLINE TO \$105 BILLION BY 1980. (3) FOOTNOTE (3) READS AS FOLLOWS: THE PUBLISHED MORGAN GUARANTY FIGURES -- ABOUT \$250 BILLION IN 1978 AND \$180 BILLION IN 1980 -- ARE IN CURRENT DOLLARS. END FOOTNOTE.

7. IN MANY PROJECTIONS IT HAS BEEN ASSUMED THAT THE PRODUCTION CUTBACKS REQUIRED TO MAINTAIN HIGH OIL PRICES ARE SHARED ROUGHLY IN PROPORTION TO PROJECTED PRODUCTIVE CAPACITY. MOST ANALYSTS HAVE ARGUED, HOWEVER, THAT IF THE CARTEL IS TO MAINTAIN, OVER TIME, PRICES AT OR NEAR THEIR CURRENT LEVEL IN REAL TERMS AND PERHAPS EVEN TO MAINTAIN ITS EXISTENCE AS AN EFFECTIVE CARTEL AT ALL, A MAJOR PROPORTION OF THE PROSPECTIVE EXCESS CAPACITY MUST BE ACCEPTED BY PERSIAN GULF PRODUCERS WITH LARGE OIL RESERVES. THESE ARE, HOWEVER, THE COUNTRIES WHO APPEAR AT THIS TIME TO BE RELATIVELY UNLIKELY TO UTILIZE MORE THAN A SMALL FRACTION OF THEIR PROSPECTIVE REVENUES FOR DIRECT IMPORTS OF GOODS AND SERVICES -- SAUDI ARABIA, THE GULF STATES. MAINTENANCE OF THE CURRENT REAL LEVEL

OF PRICES BY THIS GROUP WOULD PRODUCE A SUBSTANTIAL REDUCTION IN REVENUES OF THE COUNTRIES WITH 'LOW ABSORPTIVE CAPACITY' BY THE LATE 1970'S AND EARLY 1980'S, AND HENCE ALSO IN THE AGGREGATE OPEC CURRENT ACCOUNT SURPLUS. (IT IS INTERESTING TO NOTE THAT IT IS 'LOW ABSORBERS' WITH LARGE OIL RESERVES, COUNTRIES WHICH HAVE THE GREATEST STAKE IN MAINTAINING A LONG-RUN MARKET FOR THEIR OIL RESOURCES, WHICH ARE BEING ASKED TO UNDERTAKE A MAJOR PART OF THE ACTION REQUIRED TO MAINTAIN PRICES AT A LEVEL WHICH ENCOURAGES THE DEVELOPMENT OF ALTERNATIVE

ENERGY SOURCES.)

8. IN ADDITION TO THE ABOVE, THE RESULTS OF STUDIES OF OPEC FINANCIAL ACCUMULATIONS DEPEND UPON ASSUMPTIONS MADE ABOUT SUCH FACTORS AS THE PATTERN OF ECONOMIC RECOVERY IN THE INDUSTRIAL WORLD, THE EVOLUTION OF OPEC NATIONS' CAPACITY TO ABSORB GOODS AND SERVICES, AND THE SUCCESS OF THE IEA NATIONS IN ACCELERATING DEVELOPMENT OF ALTERNATIVE ENERGY SOURCES. THE RANGE OF USG ESTIMATES FOR OPEC FINANCIAL ACCUMULATIONS IN THE SHORT LIMITED OFFICIAL USE LIMITED OFFICIAL USE

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TERM -- THROUGH THE END OF 1977 -- IS ROUGHLY \$180-200 BILLION IN 1974 DOLLARS. THE MARGIN FOR ERROR IN SUCH ESTIMATE, OF COURSE, GROWS WITH TIME, ALTHOUGH MOST U.S. OBSERVERS FEEL THE OPEC CURRENT ACCOUNT SURPLUSES WILL PEAK BETWEEN 1978 AND 1980. A PRELIMINARY U.S. TREASURY STUDY CONCLUDES THAT THE 1980 CUMULATIVE OPEC SURPLUS WILL MOST LIKELY FALL IN THE RANGE OF \$200 TO \$250 BILLION IN TERMS OF 1974 DOLLARS. THE MAINTENANCE OF CURRENT REAL PRICE LEVELS FOR OIL IN THE ABSENCE OF AN EFFECTIVE AGREEMENT AMONG OPEC NATIONS TO SHARE CUT BACKS ROUGHLY IN PROPORTION WITH PRODUCTIVE CAPACITY YIELDS ESTIMATES IN THE LOWER PART OF THIS RANGE. INDEED, IF A VERY HIGH PROPORTION OF THE PRODUCTION CUTBACKS IS CONCENTRATED ON THE 'LOW ABSORBERS,' TOTAL OPEC ACCUMULATIONS COULD WELL FALL BELOW THE \$200 BILLION RANGE -- LOWER THAN THE PEAK IN 1977. IF THERE ARE SUBSTANTIAL PRICE REDUCTIONS OVER THE NEXT SEVERAL YEARS (IN REAL TERMS), OR OPEC INSTITUTES AN EFFECTIVE SYSTEM TO APPORTION PRODUCTION CUTBACKS ON A PRO RATA BASIS, ESTIMATES TOWARD THE UPPER END OF THE RANGE APPEAR MORE REASONABLE.

9. THE INTERNATIONAL FINANCIAL CONSEQUENCES OF THESE ACCUMULATIONS, WHILE CLEARLY REQUIRING INTERNATIONAL COOPERATION ON A MAJOR SCALE, ARE NOT INHERENTLY UN-MANAGEABLE.

10. THE ACCUMULATION OF OIL DEBTS WILL NOT UNDERMINE

THE ABILITY OF OIL IMPORTING NATIONS AS A GROUP TO PAY OFF THESE DEBTS WHEN REPAYMENT BECOMES REQUIRED. SUCH REPAYMENT CAN BE EFFECTED ONLY IN REAL TERMS, AND IN THE AGGREGATE, THE OPEC COUNTRIES CAN ONLY EXACT REPAYMENT BY RUNNING THE CURRENT ACCOUNT DEFICITS WHICH PERMIT THAT REPAYMENT. THESE REAL RESOURCE TRANSFERS WILL, AS DISCUSSED LATER, ENTAIL SUBSTANTIAL COSTS FOR THE OIL IMPORTING NATIONS, BUT THEY WILL ALSO SERVE TO MAKE THE FINANCIAL PROBLEMS TEMPORARY.

11. OBVIOUSLY, INDIVIDUAL OECD COUNTRIES COULD ENCOUNTER PROBLEMS IN ARRANGING FINANCING ON REASONABLE TERMS. BUT THIS IS A PROBLEM THAT IS WITHIN THE POWER LIMITED OFFICIAL USE
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OF THE INDUSTRIAL NATIONS AS A WHOLE TO HANDLE. IF ONE OIL IMPORTING COUNTRY IN OECD RECEIVES -- THOUGH NORMAL MARKET OPERATION -- A LESSER INFLOW OF CAPITAL THAN NEEDED TO FINANCE ITS CURRENT ACCOUNT DEFICIT, SOME OTHER OIL IMPORTING COUNTRY WILL BE RECEIVING MORE CAPITAL THAN IT REQUIRES. THE REDISTRIBUTION OF THESE FUNDS CAN BE HANDLED BY THE OECD NATIONS THEMSELVES WITHOUT TURNING TO OPEC. THE IMPORTANT THING IS THAT COUNTRIES RECOGNIZE THIS -- AS THEY HAVE DONE IN THE FINANCIAL SUPPORT FUND.

12. IT SHOULD BE NOTED FINALLY THAT THE INVESTIBLE SURPLUSES OF OPEC, NO MATTER HOW SUBSTANTIAL THEY MAY APPEAR FROM SOME POINTS OF VIEW, ARE SMALL COMPARED TO THE DEMAND FOR FUNDS ON THE PART OF NONFINANCIAL INSTITUTIONS IN THE OIL CONSUMING NATIONS.

DISTRIBUTION OF ASSETS AMONG PRODUCING COUNTRIES

13. THE WORK OF THE OECD SECRETARIAT ON THE "MEDIUM-TERM BALANCE OF PAYMENTS IMPLICATIONS OF THE OIL SITUATION" (DES/NI(75)1) SUGGESTS THAT THE CURRENT ACCOUNT SURPLUS OF THE "HIGH ABSORBER" OPEC COUNTRIES PEAKED LAST YEAR AT \$23-1/2 BILLION, WILL DECLINE TO \$13-1/2 BILLION THIS YEAR, WILL CONTINUE DECLINING RAPIDLY IN 1976 AND 1977, AND WILL NEARLY DISAPPEAR IN 1978. INCREASING DEFICITS ARE EXPECTED THEREAFTER.

14. THE CURRENT ACCOUNT SURPLUS OF THE "LOW ABSORBERS" IS ESTIMATED AT \$36-1/2 BILLION IN 1974, AND IS EXPECTED TO FALL ONLY SOMEWHAT, TO \$31-1/2 BILLION, BY THE END OF THE DECADE. THEIR SURPLUS IN 1985 IS ESTIMATED AT \$11-1/2 BILLION.

15. ALTHOUGH THE SECRETARIAT DOES NOT PROVIDE ESTIMATES FOR INDIVIDUAL OPEC COUNTRIES, IT IS A REASONABLE INTER-

PRETATION OF THEIR FIGURES THAT THEY EXPECT THE BULK OF
THE OPEC ACCUMULATIONS TO BE IN THE HANDS OF A FEW "LOW
ABSORBERS," NOTABLY SAUDI ARABIA, KUWAIT, AND THE UNITED
ARAB EMIRATES. U.S. TREASURY AND U.S. PRIVATE STUDIES
SUGGEST THAT MOST OPEC COUNTRIES WILL BE IN CURRENT ACCOUNT
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BALANCE OR IN ACTUAL DEFICIT BY 1978.

16. IT IS THUS TO BE EXPECTED THAT PERSPECTIVES ON THE
ACCUMULATION OF OPEC REVENUES WILL BE CONSIDERABLY CHANGED
IN THE NEXT SEVERAL YEARS. NEW RELATIONSHIPS WILL EVOLVE,
AND THE CONDITIONS FOR MANAGING THESE RELATIONSHIPS WILL
BE ALTERED. AT THIS STAGE, ONLY A FEW TENTATIVE CONCLUSIONS
MIGHT BE DRAWN.

17. THE MOST OBVIOUS IS THAT THE POTENTIAL PROBLEMS
ARISING FROM OPEC INVESTMENTS DEPEND VERY HEAVILY ON THE
ATTITUDES OF THE GOVERNMENTS OF THESE FEW COUNTRIES AND
ULTIMATELY PERHAPS EVEN ON THEIR POLITICAL STABILITY.
PARTICULAR ATTENTION WILL NEED TO BE GIVEN TO THE INVEST-
MENT POLICIES OF THESE COUNTRIES.

18. IT FOLLOWS ALSO THAT THE PROBLEMS POSED BY ACCUMULA-
TIONS OF OTHER OPEC COUNTRIES ARE NOT APT TO BE SERIOUS,
EITHER BECAUSE THEY ARE SMALL, OR BECAUSE THEY WILL BE
TEMPORARY. THE NEED TO ENTER INTO SPECIAL FINANCIAL
ARRANGEMENTS WITH THESE COUNTRIES IS NOT GREAT.

19. FINALLY, IT SHOULD BE APPARENT THAT THE CONCENTRA-
TION OF INVESTIBLE FUNDS IN THE HANDS OF ONLY A FEW
COUNTRIES MEANS THAT THESE COUNTRIES CAN BE EXPECTED TO
BE VERY CONSCIOUS OF THE STAKE THEY HAVE IN A FRIENDLY
ENVIRONMENT FOR THEIR INVESTMENTS IN THE CONSUMING
COUNTRIES.

INVESTMENT POLICIES OF PRODUCING COUNTRIES (UNDERScore)

20. ANOTHER POSSIBLE SOURCE OF CONCERN DERIVES FROM THE
INVESTMENT POLICIES OF THE PRODUCING COUNTRIES AS REGARDS
MATURITIES OR GEOGRAPHIC AND CURRENCY DISTRIBUTION; TYPE
OF ASSET, AND VOLATILITY AND MATURITY OF THE INVESTMENT.

21. U.S. ESTIMATES OF THE GEOGRAPHIC DISTRIBUTION OF
OPEC INVESTMENTS IN 1974 ARE ANNEXED. THE PATTERN APPEARS
TO BE RELATIVELY WIDELY DISPERSED.

22. DETAILED STATISTICAL INFORMATION REGARDING THE
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CURRENCY DISTRIBUTION OF OPEC INVESTMENTS IS NOT AVAILABLE. THERE ARE INDICATIONS THAT PRODUCER COUNTRIES ARE DIVERSIFYING THE CURRENCY DISTRIBUTION OF THEIR HOLDINGS, TO SOME EXTENT. NEVERTHELESS, IT SEEMS LIKELY THAT THE PRINCIPAL VEHICLE CURRENCY WILL REMAIN THE U.S. DOLLAR. ANY OTHER RESULT WOULD SEEM TO REQUIRE A MARKED CHANGE IN ATTITUDES OF A NUMBER OF KEY FOREIGN MONETARY AUTHORITIES TOWARD USE OF THEIR CURRENCIES IN INTERNATIONAL TRANSACTIONS.

23. THE ANNEXED TABLE ALSO PROVIDES SOME INDICATION OF THE TYPE OF ASSETS IN WHICH PRODUCER COUNTRIES ARE INVESTING, AS WELL AS THEIR MATURITY AND LIQUIDITY. PROBABLY 25 TO 30 PERCENT OF OPEC PLACEMENTS LAST YEAR WAS IN NON-LIQUID ASSETS SUCH AS DIRECT LOANS TO DEVELOPED COUNTRIES AND DEVELOPING COUNTRIES, LENDING TO THE INTERNATIONAL FINANCIAL INSTITUTIONS, AND THE 'ALL OTHER' CATEGORY, WHICH INCLUDES SECURITIES AND REAL ESTATE, ETC.

24. U.S. STATISTICS SUGGEST THAT PERHAPS 90 PERCENT OF OPEC'S DOLS 11-1/4 BILLION OF INVESTMENTS IN THE U.S. IN 1974 MAY HAVE BEEN IN SHORT-TERM ASSETS. TOWARD THE END OF THE YEAR, HOWEVER, THERE WAS AN IMPORTANT AND PERHAPS SIGNIFICANT TREND TOWARD PLACEMENTS IN INSTRUMENTS WITH LONGER MATURITIES AND IN EARLY 1975, THE PROPORTION OF THE TOTAL FALLING IN THIS CATEGORY WAS QUITE HIGH. THERE ARE INDICATIONS THAT A SUBSTANTIAL PORTION OF FUNDS INVESTED ELSEWHERE IN RECENT MONTHS IS ALSO LONG-TERM IN NATURE. REPORTS CONTINUE TO MOUNT OF DIRECT LOANS TO CONSUMER GOVERNMENTS OR GOVERNMENTAL ENTITIES, DIRECT PURCHASES OF

OFFICIAL AND QUASI-OFFICIAL BOND ISSUES, LOANS TO INTERNATIONAL INSTITUTIONS, AND LONG-TERM BANK DEPOSITS IN ACCORDANCE WITH GOVERNMENT-TO-GOVERNMENT UNDERSTANDINGS.

25. CONCEPTUALLY, THERE IS NO MATURITIES PROBLEM FOR THE OIL CONSUMING COUNTRIES AS A GROUP. NO MATTER HOW LIQUID THE PLACEMENTS BY THE PRODUCING COUNTRIES MIGHT BE IN NOMINAL TERMS, THESE INVESTMENTS ARE EFFECTIVELY "LOCKED IN" FOR THE OIL CONSUMING COUNTRIES AS A GROUP UNTIL THE PRODUCERS ARE PREPARED TO ACCEPT THE CURRENT LIMITED OFFICIAL USE
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ACCOUNT DEFICITS WHICH PERMIT REPAYMENT. SHORT-TERM MATURITIES, THEN, MAINLY SERVE TO INCREASE THE FLEXIBILITY OF THE OIL PRODUCING COUNTRIES TO SHIFT THEIR PLACEMENTS AMONG COUNTRIES AND INSTITUTIONS.

26. SEVERAL POINTS MIGHT BE MADE ABOUT THE POTENTIAL

PROBLEMS ARISING FROM THIS FLEXIBILITY. FIRST, THIS IS A FLEXIBILITY WHICH OIL PRODUCING COUNTRIES ARE GOING TO DEMAND IN ANY CASE FOR A MAJOR PORTION OF THEIR INVESTMENTS, FOR WELL-KNOWN RESERVE MANAGEMENT REASONS. SECOND, GIVEN THE BREADTH OF THE DEVELOPED CAPITAL MARKETS, MOST LONG-TERM INVESTMENTS USUALLY ARE MOBILIZABLE, IF OFTEN AT A COST. THIRDLY, THOSE MOST CONCERNED ABOUT THE MATURITIES PROBLEM WILL BE FINANCIAL INTERMEDIARIES WHO WILL INCREASINGLY FIND PRODUCING COUNTRY SHORT-TERM PLACEMENTS LESS ATTRACTIVE, AND EITHER SEEK LONGER MATURITIES OR SHUNT PRODUCING COUNTRY INVESTORS INTO OTHER CHANNELS. IT IS UNREALISTIC TO EXPECT THAT CONSUMING COUNTRIES COULD DEPRIVE OPEC INVESTORS OF FLEXIBILITY BY INDUCING THEM TO TIE UP SUCH A LARGE PORTION OF THEIR FUNDS IN NON-MARKETABLE LONG-TERM CREDIT THAT THEY WERE FINANCIALLY UNABLE EITHER TO INVEST IN SPECIFIC FIRMS OR TO SHIFT FUNDS FROM ONE COUNTRY OR CURRENCY TO ANOTHER IF THEY WERE DETERMINED TO DO SO REGARDLESS OF FINANCIAL COSTS.

27. EVEN THOUGH OPEC INVESTORS MUST BE EXPECTED TO RETAIN LARGE SUMS IN NOMINALLY HIGHLY LIQUID FORM, THERE IS LITTLE REASON FOR OIL CONSUMING COUNTRIES -O FEAR THAT ABRUPT SHIFTS OF SUCH FUNDS WOULD CAUSE A BREAKDOWN OF THE WORLD FINANCIAL SYSTEM. A FACTOR WHICH BOTH REDUCES THE INCENTIVES FOR MAJOR SHIFTS AMONG COUNTRIES AND CURRENCIES IN A VOLATILE MANNER AND WHICH OFFERS A GREATER DEGREE OF PROTECTION TO NATIONAL ECONOMIES AGAINST SUCH SHIFTS AS MAY OCCUR IS THE GREATER FLEXIBILITY IN EXCHANGE RATE POLICIES AND PRACTICES OF MOST COUNTRIES. LARGE, ABRUPT SHIFTS IN FUNDS BETWEEN CURRENCIES WOULD LEAD TO LARGE, ABRUPT SHIFTS IN EXCHANGE RATES WHICH WOULD SERVE TO MAKE MOVING FUNDS IN THIS MANNER A FINANCIALLY UNATTRACTIVE PROPOSITION

TO OPEC COUNTRIES, PARTICULARLY SINCE, AFTER THE STOCK ADJUSTMENT, RATES WOULD TEND TO RETURN TOWARD PREVIOUS LIMITED OFFICIAL USE
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LEVELS.

28. THERE WILL INEVITABLY BE STRAINS RESULTING FROM THE GEOGRAPHIC AND CURRENCY DISTRIBUTION OF PRODUCER COUNTRY INVESTMENTS. IT CANNOT BE EXPECTED THAT THE PATTERN OF OPEC LENDING AND INVESTING WILL COINCIDE PRECISELY WITH THE BORROWING REQUIREMENTS OF OIL CONSUMING COUNTRIES. BEYOND THIS, OPEC LENDERS, RECOGNIZED AS GENERALLY STRONG RISK AVERTERS, WILL FREQUENTLY SEEK TO MINIMIZE RISK AT A TIME WHEN RISKS HAVE BEEN INCREASED FOR SOME COUNTRIES MORE THAN OTHERS.

29. ONE MITIGATING FACTOR WILL BE THE DESIRE OF LENDERS TO DIVERSIFY THEIR INVESTMENT PORTFOLIOS. POLITICAL-

MILITARY FACTORS, AS WELL AS THE USUAL ECONOMIC CONSIDERATIONS, DICTATE SUCH DIVERSIFICATION, AND TO DATE THERE HAS BEEN NO SIGN OF ANY TENDENCY TO CONCENTRATE THEIR LENDING IN THE NATIONAL FINANCIAL MARKETS OF ONE OR TWO COUNTRIES. IN FACT, AS TIME HAS PASSED, THE DIVERSITY--BOTH GEOGRAPHIC AND BY DEBT INSTRUMENT--OF OPEC LENDING HAS INCREASED.

30. REINFORCEMENT OF COOPERATIVE FINANCIAL ARRANGEMENTS AMONG THE CONSUMING COUNTRIES WOULD ALSO GREATLY REDUCE THE STRAINS. OF PARTICULAR IMPORTANCE IS THE ASSURANCE THAT FINANCING WILL BE AVAILABLE TO INDIVIDUAL CONSUMING COUNTRIES ON REASONABLE TERMS IF NEEDED. THIS IS, AGAIN, THE RATIONALE FOR THE OECD FINANCIAL SUPPORT FUND. BEYOND THIS, CENTRAL BANKS WILL HAVE TO STAND READY TO RESPOND TO LIQUIDITY PROBLEMS OF THEIR BANKING SYSTEMS; THEY HAVE BEEN REVIEWING THE ADEQUACY OF THESE ARRANGEMENTS WITHIN THE BIS FRAMEWORK. FINALLY, THERE IS A NEED TO COME TO GRIPS WITH THE PROBLEMS OF SOME LDC'S WHOSE FINANCIAL REQUIREMENTS MAY BE DIFFICULT TO MANAGE. THIS REMAINS A SERIOUS PROBLEM FACING THE INTERNATIONAL COMMUNITY. WORK ON THIS PROBLEM IS UNDERWAY IN OTHER FORUMS, PRIMARILY IN THE DEVELOPMENT COMMITTEE.

31. IT MAY ALSO LEGITIMATELY BE ASKED WHETHER THE VARIETY OF INVESTMENTS AVAILABLE IS ADEQUATE OR APPROPRIATE FOR THE NEEDS OF OPEC INVESTORS. WHILE THERE IS CERTAINLY ROOM FOR NEW INNOVATIONS ON THE PART OF THE PRIVATE SECTOR, LIMITED OFFICIAL USE
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THE EXISTING VARIETY OF INSTRUMENTS IS QUITE IMPRESSIVE, AND IN MOST INSTANCES GOVERNMENT DEBT WOULD BE AVAILABLE, OR COULD BE MADE AVAILABLE, FOR PURCHASE BY OPEC INVESTORS, IF THE RANGE OF EXISTING AND POSSIBLE NEW ASSETS AVAILABLE THROUGH THE PRIVATE SECTOR SHOULD FAIL TO SATISFY OPEC PREFERENCES (WHICH MAY ALSO CHANGE OVER TIME).

32. ANOTHER POSSIBLE SOURCE OF CONCERN IS THAT THE INVESTMENT INSTRUMENTS AVAILABLE MAY NOT BE SUFFICIENTLY LIQUID TO MEET OPEC PREFERENCES. FROM THE VIEWPOINT OF THE CONSUMING COUNTRIES, HOWEVER, THIS IS NOT A PARTICULAR PROBLEM UNLESS THEY ARE IN NEED OF THE FUNDS IN QUESTION, ON SUCH LIQUID TERMS. OVER A REASONABLE PERIOD OF TIME, THE FINANCIAL MARKETS (INCLUDING GOVERNMENT PARTICIPANTS) CAN BE RELIED ON TO DEVELOP INSTRUMENTS WHICH BALANCE THE LIQUIDITY AND OTHER PREFERENCES OF LENDERS AND BORROWERS AT MARKET CLEARING TERMS.

33. PRODUCING COUNTRY INVESTMENTS COULD, OF COURSE, REPRESENT SUBSTANTIAL INFLUENCES ON THE DOMESTIC MARKETS OF MANY COUNTRIES. THE REDISTRIBUTION OF WEALTH TOWARD INVESTORS WITH A STRONG PREFERENCE FOR SHORT-TERM ASSETS COULD RESULT IN A CHANGE IN YIELD CURVES. THIS COULD

PLACE GREATER RESPONSIBILITIES ON FINANCIAL INTERMEDIARIES. TOO, SUBSTANTIAL SECURITY PURCHASES COULD DRIVE INTEREST RATES DOWN OR SECURITY PRICES UP, AND SALES THE REVERSE. IN THE LATTER CASE, HOWEVER, IT IS NOT IN THE INTEREST OF THE OPEC INVESTOR TO SEE THIS HAPPEN. IT MAY THUS BE IN THE INTEREST OF BOTH INVESTOR AND THE COUNTRY IN WHICH INVESTMENTS ARE MADE TO EXPLORE THE POSSIBILITY OF ARRANGEMENTS WHICH MINIMIZE AN UNDESIRABLE IMPACT ON MARKETS.

34. IT SHOULD BE NOTED THAT THE INSTRUMENTS IN WHICH OPEC COUNTRIES INVEST NEED NOT BEAR ANY CLOSE RELATIONSHIP TO THE LEVELS AND PATTERNS OF INVESTMENT IN CONSUMING COUNTRIES. GIVEN THE HIGH DEGREE OF FUNGIBILITY OF CAPITAL, THE EFFECTS OF CAPITAL IMPORTS ON TOTAL DOMESTIC INVESTMENT WILL DEPEND IN MOST NATIONS MUCH MORE ON DOMESTIC ENTREPRENEURSHIP AND NATIONAL MICRO- AND MACROECONOMIC POLICIES TOWARD SAVINGS AND INVESTMENT THAN ON THE PARTICULAR FORM OF CAPITAL FLOWS.

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THE REAL RESOURCE ALLOCATION PROBLEM (UNDERScore)

35. IT IS IMPORTANT TO BEAR IN MIND THAT THE PRIMARY ECONOMIC COSTS OF THE OIL PRICE INCREASES ARE NOT FINANCIAL BUT REAL. MOST OBVIOUSLY, THEY ARE MEASURED IN TERMS OF THE ADDITIONAL REAL RESOURCES TRANSFERRED TO OPEC. IN ADDITION, HOWEVER, THERE ARE HEAVY ADJUSTMENT COSTS FOR OIL CONSUMING COUNTRIES ARISING OUT OF THE ACCELERATION OF INFLATION, FRICTIONAL UNEMPLOYMENT, AND ACCELERATED CAPITAL OBSOLESCENCE AS COUNTRIES ADJUST THEIR INDUSTRIAL STRUCTURES TO A VERY MAJOR CHANGE IN THE RELATIVE PRICE OF INPUTS. THE LOSSES INCURRED IN THE PROCESS OF AN ABRUPT, FORCED STRUCTURAL ADJUSTMENT OF THE ENTIRE INDUSTRIAL WORLD SHOULD NOT BE UNDERESTIMATED.

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36. EVEN WHEN THE SHORT-RUN EFFECTS ARE DISSIPATED, LEVELS OF REAL INCOME IN THE OIL IMPORTING NATIONS AT ANY POINT IN TIME IN THE FUTURE WILL BE SUBSTANTIALLY LOWER THAN THEY WOULD HAVE BEEN OTHERWISE, NOT ONLY BECAUSE OF THE CONTINUING COSTS OF HIGH OIL PRICES, BUT ALSO BECAUSE OF THE ONCE-FOR-ALL REDUCTION IN EFFICIENCY OF THE EXISTING CAPITAL STOCK CAUSED BY THE TRANSITIONAL ADJUSTMENT TO THE HIGH OIL PRICES. THERE WILL PROBABLY ALSO BE SOME FURTHER IMPETUS TO INFLATIONARY PRESSURES EVERYWHERE, INsofar AS CHEAP ENERGY IN THE PAST HELPED TO OFFSET OTHER RISING COST PRESSURES, AND THERE COULD BE CONTINUING COST PUSH PRESSURES ON PRICES.

37. IN THE ABSENCE OF A DEGREE OF REALIZATION -- NOT SO FAR IN EVIDENCE -- ON THE PART OF AT LEAST CERTAIN OPEC COUNTRIES OF THEIR OWN LONG-RUN ECONOMIC INTERESTS, MANY

OF THE REAL COSTS OF OVERPRICED OIL ARE PROBABLY UNAVOIDABLE. IT REMAINS TO BE CONSIDERED, HOWEVER, WHETHER POLICIES TO INFLUENCE THE RATE AT WHICH REAL RESOURCES ARE TRANSFERRED TO THE PRODUCING COUNTRIES ARE IN THE INTEREST OF THE CONSUMING COUNTRIES. THIS POTENTIAL TRANSFER CANNOT BE REGARDED AS INSIGNIFICANT -- LAST YEAR ALONE, INCREASED OIL PAYMENTS WERE ON THE ORDER OF 15 PERCENT OF WORLD TRADE.

38. IN ANNEX E TO CPE/TWP(75)1, THE OECD SECRETARIAT HAS COMMENTED ON SEVERAL ASPECTS OF THIS QUESTION. ONE POINT LIMITED OFFICIAL USE
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MADE IS THAT THE ATTITUDE OF THE OECD COUNTRIES TOWARD THE RATE OF TRANSFER OF REAL RESOURCES WILL VARY WITH THE OVERALL LEVEL OF CAPACITY UTILIZATION IN THEIR ECONOMIES. ANOTHER INTERESTING POINT MADE IS THAT THERE IS PROBABLY NOT MUCH THE OECD COUNTRIES AS A GROUP CAN DO TO ACCELERATE THE ACTUAL TRANSFERS OF REAL RESOURCES ABOVE THE LEVEL THAT COULD BE REACHED AS A RESULT OF THE EFFORTS OF THE OPEC COUNTRIES (THE SECRETARIAT DOES SEE SOME POSSIBILITIES OF SLOWING DOWN THIS TRANSFER). TAKEN IN CONJUNCTION, THESE TWO CONCLUSIONS SUGGEST THAT AT LEAST IN CERTAIN CIRCUMSTANCES, FOR EXAMPLE, WHEN THEY ARE EXPERIENCING PRESSURES TO ELIMINATE EXCESS CAPACITY, THE OECD COUNTRIES SHOULD BE ALERT TO AVOID EXCESSIVE COMPETITION IN EXPORTS AND IN TECHNOLOGICAL TRANSFERS TO THE OECD COUNTRIES.

39. QUITE APART FROM THE QUESTION OF THE MAGNITUDE OF THE REAL RESOURCES TO BE TRANSFERRED, THERE IS A QUESTION WHETHER DISTINCTIONS SHOULD NOT BE MADE AMONG THE TYPES OF RESOURCE TRANSFERS. FOR THE NEXT SEVERAL YEARS, IT SEEMS MORE LIKELY THAN NOT THAT DEMAND WILL BE CONCENTRATED ON INDUSTRIES PRODUCING GOODS MOST IN DEMAND IN INDUSTRIAL COUNTRIES. DEMAND FOR CAPITAL GOODS PROMISES

TO BE STRONG, AS THE ADJUSTMENTS IN THE ENERGY FIELD ARE UNDERTAKEN. THE BURDEN OF TRANSFERRING REAL RESOURCES IN THE FORM OF AUTOMOBILES, A SECTOR WHICH THREATENS TO SEE EXCESS CAPACITY FOR SOME TIME, IS FAR DIFFERENT FROM THE BURDEN OF SUPPLYING REAL RESOURCES IN THE FORM OF OIL DRILLING RIGS, A SECTOR OPERATING AT HIGH LEVELS OF CAPACITY TO PRODUCE EQUIPMENT OF CRITICAL IMPORTANCE IN THE PRESENT CIRCUMSTANCES. IN SUM, THE COSTS OF TRANSFERRING REAL RESOURCES TO OPEC ARE APT TO BE GREATER THAN IMPLIED BY THE MAGNITUDE ALONE, BECAUSE THEY WILL BE WANTING GOODS IN SHORT SUPPLY.

40. HIGHER COSTS OF ENERGY WILL ALSO MEAN (A) A REDUCED SUPPLY OF FUNDS AVAILABLE THROUGHOUT THE WORLD FOR NON-

ENERGY USES, BECAUSE OF THE ENHANCED DEMANDS FOR CAPITAL
TO PRODUCE ENERGY FROM NON-OPEC SOURCES, AND (B) SOME
CHANGES IN THE LOCATION OF THE WORLD'S INDUSTRY, IN-
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CREASING THE SHARE OF THE WORLD'S MANUFACTURING CAPACITY
IN THE OPEC COUNTRIES RELATIVE TO THE SHARES OF SUCH
CAPACITY IN THE MOST HIGH COST COMPETING AREAS.

41. ONE COURSE THAT WOULD BE HELPFUL TO MAINTAINING A
HIGHER RATE OF GROWTH IN THE LONG-RUN STANDARD OF LIVING
OF INDUSTRIAL COUNTRIES WOULD BE TO TRY TO SHIFT MORE
RESOURCES FROM CONSUMPTION TO INVESTMENT. THE NEED TO
INCREASE THE SHARE OF TOTAL RESOURCES DEVOTED TO INVEST-
MENT IS REINFORCED BY THE NEED TO CREATE CAPACITY FOR AN
EVENTUAL REAL TRANSFER TO THEIR FOREIGN CREDITORS.
BORROWING ABROAD TO FINANCE DOMESTIC CONSUMPTION IS NOT
A VIABLE LONG-TERM POLICY, THOUGH TO SOME DEGREE IT MAY
BE NECESSARY IN THE SHORT-RUN TO AVOID SEVERE ECONOMIC
DISRUPTION.

42. THE FOREGOING DISCUSSION INDICATES THAT A GOOD MANY
QUESTIONS SHOULD BE ASKED ABOUT SUGGESTIONS THAT COUNTRIES
IN RELATIVELY WEAK PAYMENTS POSITIONS MAKE SPECIAL EFFORTS
TO EXPAND THEIR EXPORTS TO OPEC AND THAT ALL INDUSTRIAL
COUNTRIES CONSIDER WAYS OF INCREASING THE ABSORPTIVE
CAPACITY OF PRODUCER COUNTRIES. IT MAY BE THAT THE
WORKING PARTY SHOULD UNDERTAKE A MORE DETAILED ANALYSIS
OF THESE QUESTIONS.

END TEXT

THERE FOLLOWS TABLE REFERENCED IN PARAS 21 AND 23:

ESTIMATED OPEC INVESTMENTS DURING 1974

	ESTIMATED \$ BILLION	PERCENT OF TOTAL
IN THE UNITED STATES	11 1/4	19
IN EURO-BANKING MARKET	22 1/2	37 1/2

(EURO-CURRENCY DEPOSITS,
WITH UK AND OTHER
EURO-CURRENCY BANKS)
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OTHER IN UNITED KINGDOM	7 1/2	12 1/2
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OTHER DEVELOPED COUNTRIES:	5 1/2	9
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DIRECT OFFICIAL OR QUASI-
OFFICIAL BORROWING

IFI BONDS AND IMF OIL FACILITY	3 1/2	6
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OTHER FLOWS (INCL. GRANTS)
TO LDC'S

4	6 1/2
---	-------

ALL OTHER	5 3/4	9 1/2
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(INCLUDES ESTIMATES FOR
PRIVATE-SECTOR LOANS,
SECURITIES, & REAL ESTATE
IN CONTINENTAL EUROPE, AND
UNEXPLAINED RESIDUAL)

TOTAL	60	100
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TREASURY:OASIA
REVISED 4/30/75

FOLLOWING ARE CORRECTIONS TO BE MADE IN FORGOING TEXT:

1. REVISE FOURTH SENTENCE PARA 7 TO READ "MAINTENANCE
OF THE CURRENT REAL LEVEL OF PRICES BY MEANS OF CUTBACKS
BY THIS GROUP WOULD PRODUCE A SUBSTANTIAL REDUCTION IN
THEIR REVENUES AND HENCE ALSO IN THE AGGREGATE OPEC
CURRENT ACCOUNT SURPLUS."

2. REVISE LAST PHRASE PARA 38 TO READ "TO THE OPEC
COUNTRIES". KISSINGER

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<< END OF DOCUMENT >>

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